

Aqua America, Inc. (WTR)

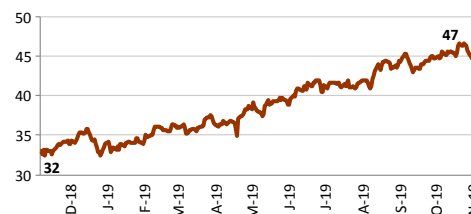
First Look at Q3 Results

Reiterate Outperform rating after Q3 earnings release. WTR reported results which were in line with consensus estimates, and the company reaffirmed adj. EPS guidance of \$1.45 to \$1.50 (excluding impact of Peoples acquisition). Importantly, the Peoples acquisition is now expected to close in late 2019 or early 2020 (vs. prior expectation of fall 2019), though WTR appears to be progressing through regulatory proceedings; we believe this is the most important driver of the stock. Additionally, WTR has received \$59.8M in annualized revenue increases YTD.

- **Q3 results were in line with consensus EPS estimates due to rate increases and new customers from acquisitions and organic growth.** Q3 revenue was ~\$243.6M vs. our/consensus estimates of \$241M/\$250M, as additional revenue from infrastructure surcharges contributed to ~7.7% growth y/y. Non-GAAP net income (excluding impacts of Peoples transaction-related expenses) was \$85.6M vs. \$86M/\$88M, and EPS was \$0.48 vs. \$0.48/\$0.44, respectively, due to rate increases and regulated growth.
- **WTR reaffirmed 2019 guidance, excluding impact of Peoples acquisition.** WTR continues to expect \$1.45 to \$1.50 in EPS in 2019 (excluding impacts of Peoples transaction), total customer growth of ~2%-3%, and ~\$550M in infrastructure investments.
- **Peoples acquisition now expected to close in late 2019 or early 2020 (vs. prior expectation of fall 2019), though WTR appears to be progressing through regulatory proceedings.** Kentucky and West Virginia approved the Peoples acquisition in March and April, respectively. In Pennsylvania, the Administrative Law Judge issued a recommended decision determining WTR is fit to control Peoples and that the acquisition would be positive for the public; the Pennsylvania Utility Commission will now review the recommendation and issue a final order. WTR now expects the acquisition to close in late 2019 or early 2020.
- **Acquisition activity should continue to drive customer growth in the water business; WTR announced an agreement to acquire DELCORA's wastewater assets for ~\$276.5M in Q3.** WTR has signed purchase agreements which are expected to add ~22.6k customer connections by early 2020 (~\$110M in rate base, on aggregate). Additionally, WTR announced an agreement to acquire DELCORA's wastewater assets; the largest municipal acquisition in company and Pennsylvania history (see: [Municipal Acquisition](#)); we will look for more information on the conference call.
- **Rate increases and surcharges continue to contribute to revenue growth.** WTR has received \$59.8M in annualized revenue increases thus far in 2019 due to favorable decisions in rate cases and infrastructure charges in five states.
- **WTR's Q3 earnings call will be held today at 10:00 a.m. CT.** The call can be accessed at www.ir.aquaamerica.com.

RESEARCH UPDATE

1-Year Price Chart



Stock Data

Rating:	Outperform
Suitability:	Lower Risk
Price Target:	\$44
Price (11/4/19):	\$43.56
Market Cap (mil):	\$9,574
Shares Out (mil):	219.8
Average Daily Vol (mil):	1.15
Dividend Yield:	2.2%

Estimates

FY Dec	2018A	2019E	2020E
Q1	0.29 A	0.28 A	
Q2	0.37 A	0.37 A	
Q3	0.44 A	0.48 A	
Q4	0.31 A	0.35 E	
Fiscal EPS	1.41 A	1.48 E	1.57 E
Fiscal P/E	30.9x	29.4x	27.7x

Chart/Table Sources: FactSet and Baird Data. Price chart reflects most recent closing price.

Please refer to Appendix
- Important Disclosures
and Analyst Certification

Aqua America is a holding company for numerous regulated water/waste water utilities serving almost 3.0 million people in the eastern half of the U.S.

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Investment Thesis

US water infrastructure needs should drive long-term earnings growth. The water infrastructure in the United States is in significant need of upgrade and expansion. We believe a significant long-term earnings growth driver for WTR comes from substantial capital investment opportunities, which contribute to rate base growth, and in turn, drives earnings.

Peoples acquisition, a natural gas utility, should add another platform for organic growth. The combined entity is expected to have ~\$10.8B in assets and a rate base of >\$7.2B, 70% in water and wastewater and 30% in natural gas. We estimate WTR paid ~14.8x EV/EBITDA (based on an enterprise value of \$4.275B and 2019E EBITDA of \$289M) for the assets. The transaction is subject to regulatory approvals, including approval by public utility commissions in Pennsylvania, Kentucky, and West Virginia, and is expected to close in late-2019.

Planned capital investment should expand rate base and generate growth for the company in the long run. We expect Aqua America's long-term EPS growth to be fueled in part by the company's ~\$500 million annual capex investment. \$1.4B is expected to be invested into system upgrades (main, pipes, hydrants, etc.) over the next three years, which provides direct value to customers. Discretionary system investments are typically targeted for states with enhanced recovery mechanisms which help stabilize margin and earnings consistencies despite accelerated investment.

The majority of WTR's regulatory operations are located in states that maintain enhanced regulatory recovery mechanisms. The majority of WTR's current operating system employs infrastructure mechanisms, which allow a return on investment outside of a full rate case, substantially reducing regulatory lag time and minimizing rate case activity. These regulatory mechanisms include infrastructure investment riders, statewide rates and incentive mechanisms for acquisitions of troubled water systems. We believe such mechanisms provide a constructive regulatory environment in which to make capital investments, enabling improved and more consistent earned returns, which should lead to a premium peer valuation.

Continued municipal water acquisitions should help customer growth. The company targets 2-3% customer growth in 2019 driven by acquisitions of municipal utilities. Aqua has successfully acquired numerous water and waste water systems in the past decade to supplement its internal growth. Acquisitions also provide significant follow-on investment opportunities as WTR improves the quality of an acquired water system. The company is expected to be a key player in consolidating some of the 53,000 private water systems in the U.S., and rehabilitating those systems to improve water quality and drive investment growth.

\$44 price target. Our price target is based on a ~28x P/E multiple on our 2020 EPS estimate, which is in line with comps which are currently trading at a ~24x-31x multiple. We believe this is justified as WTR integrates the Peoples acquisition.

Risks & Caveats

Our suitability rating on Aqua America is Lower Risk. Key risks include the following.

Regulation. Regulated operations are subject to local, state and federal regulations. Changes in the regulatory environment can affect WTR's near-term and long-term performance.

Weather. WTR's businesses are sensitive to fluctuations in the weather. Particularly wet or dry weather can impact near-term financial results.

Acquisition risk. WTR may have the opportunity to purchase assets or companies in the near future. Acquisitions carry risks related to personnel, expected-versus-actual growth and a myriad of unforeseen hurdles, all of which can negatively affect earnings.

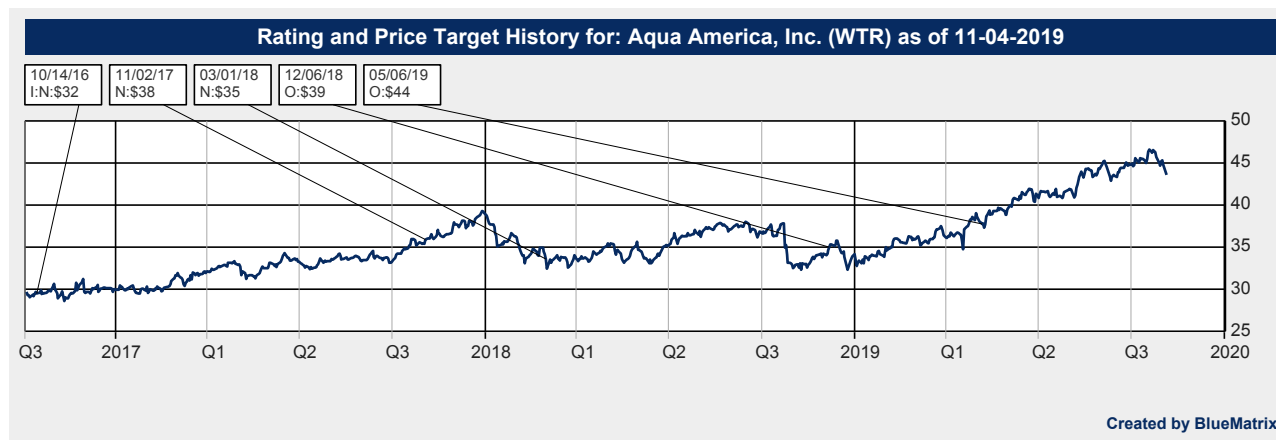
Product quality. Unique among its sister regulated utility sectors, water utilities provide a product that is ingested. Despite robust mandated service quality standards that lower risk, a quality failure could materially impact the earnings and stock of WTR.

Company Description

Aqua America is a holding company for regulated utilities providing water and waste water services to nearly 3 million people located in the eastern half of the U.S. Over 50% of operating revenues and net income are derived from Pennsylvania.

Appendix - Important Disclosures and Analyst Certification

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2 Robert W. Baird & Co. Incorporated and/or its affiliates managed or co-managed a public offering of securities of Aqua America, Inc. in the past 12 months.

3 Robert W. Baird & Co. Incorporated and/or its affiliates have received investment banking compensation from Aqua America, Inc. in the past 12 months.

1 Robert W. Baird & Co. Incorporated makes a market in the securities of WTR.

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